(6)

Supreme Court of the United States

No. 213

Term A. D. 1944.

F. G. BADENHAUSEN, WILLIAM S. SPATCHER and HOWARD H. HUBBARD, constituting the Protective Committee for the Holders of Georgia and Alabama Railway First Mortgage Consolidated Five Percent Gold Bonds,

Petitioners and Appellants Below,

AGAINST

OTIS A. GLAZEBROOK, JR., JOSEPH FRANCE and CHARLES MARKELL, as the Reorganization Committee of the Seaboard Air Line Railway Company, *et al.*,

Respondents and Appellees Below.

PETITION AND BRIEF FOR WRIT OF CERTIORARI.

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CASES CITED.

STATUTES CITED.

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PETITION FOR WRIT OF CERTIORARI.

To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:

The petition of F. G. Badenhausen, William S. Spatcher and Howard H. Hubbard, constituting the Protective Committee for the Holders of Georgia and Alabama Railway First Mortgage Consolidated Five Percent Gold Bonds, respectfully shows:

Summary Statement of the Matter Involved.

The petitioners seek a review of the final determination of the Circuit Court of Appeals for the Fifth Circuit dated April 10, 1945, which affirmed the decree of the District Court of the United States for the Southern District of Florida entered September 14, 1943, confirming and approving the Report of the Special Master and the Special Master's Plan of Reorganization together with the modifications made by the District Courts.

Petitioners herein constitute a protective committee duly authorized by the Interstate Commerce Commission to represent and act for the holders of Georgia and Alabama Railway First Mortgage Bonds, one of the underlying first mortgage issues of the Seaboard System.

Facts as to Seaboard System.

The system of railroads known as the Seaboard Air Line Railway (hereinafter called "Seaboard") consists of about 4,000 miles of railroad operating in the fourth and fifth judicial circuits. Receivers were appointed for the Seaboard by the United States District Court for the Eastern District of Virginia ("Virginia Court") in proceedings instituted by a general creditor. The defendant, Seaboard Air Line Railway Company, consented to the receivership. Ancillary proceedings were instituted on the same day in the District Court of the United States for the Southern District of Florida ("Florida Court").

From time to time, and in subsequent years, foreclosure bills were filed in those proceedings by the trustees under the various mortgages secured by property owned by the Seaboard. The causes have been consolidated.

Included in the 4,000 miles of railroad presently owned or operated by the Seaboard System are over 2,000 miles which are subject to ten separate *underlying* divisional mortgages originally created by predecessor companies

prior to the merger and consolidation of the Seaboard System. The total of principal and unpaid interest on these "underlying mortgages" held by the public (as of January 1, 1943) amounted to $48,550,000.*

Subordinate to these underlying liens, but constituting first liens on certain portions of the whole railroad system, are four *general* mortgages. The total principal and interest of these general mortgage bonds publicly held (as of January 1, 1943) aggregated $160,400,000. During the course of the Receivership, the Receivers incurred obligations aggregating in all $38,413,000. In addition, there were $36,800,000 of Seaboard collateral trust obligations and other general unsecured claims. The grand total of principal and interest of the secured debt in the hands of the public was $340,250,000, exclusive of capital stock. The par value of the outstanding capital stock of the Seaboard, preferred and common, aggregated $85,110,000.**

During the years 1942 and 1943, the Receivers purchased and acquired about *$34,000,000* par value of outstanding Receivers' certificates and other secured obligations of the System *from wartime earnings.* Nearly all of the securities were so acquired under orders of the Court to the effect that the application of the monies therefor should be without prejudice to the claims of parties in interest with respect to the monies so used. During the Receivership, and prior to 1943, the Receivers also applied upwards of $50,000,000 in betterments to the Railroad System.

On October 27, 1939, the "Virginia Court" entered an order appointing Tazewell Taylor, Esq., as Special Master, to prepare and submit a plan of reorganization after hearings of all parties in interest. A similar order

*To avoid confusion, round figures will frequently be used.

**The District Courts found the Seaboard insolvent. The Adjustment Mortgage bonds which were junior to the Refunding Mortgage, the unsecured debt and stock of the Seaboard were not entitled to participate in the reorganization because the new capitalizaion would be insufficient to fully satisfy the claims of the holders of the secured debt (R. Vol. I, 91).

was entered by the "Florida Court". The Special Master conducted hearings at various times commencing March 4, 1940 and terminating on July 24, 1942, considered various plans of reorganization, and on July 20, 1943, submitted his Report and Plan of Reorganization.

After the receipt of the Report, exceptions and objections to the Special Master's Report were filed by many parties, including the petitioners herein. A hearing on those exceptions was set for October 25, 1943. At that hearing, Judge Chesnut (designated to take charge of the proceedings in the "Virginia Court" on account of the illness and subsequent death of Judge Way) and Judge Akerman, of the "Florida Court", *sat jointly*. Hearings were held on the objections and further evidence was submitted during the period from October 25th to November 5th, 1943.

At the conclusion of the hearings on the objections to the Plan, the District Courts rendered their tentative decision, and then discussed the practical or business aspect of deciding the issues before the Courts on a *compromise basis* rather than on a legal or judicial basis, in order to expedite the reorganization at that particular time when the earnings of the System were at their highest level (R. Vol. I, 365-368). The Courts suggested that a "Compromise Committee" be appointed to negotiate with the interested parties whose rights appeared to be adversely affected by the Master's Plan, so that a plan of reorganization could be confirmed that would be agreeable *by consent* to *all* interested participating parties (R. Vol. I, 365-368; see original Court transcript, pp. 1369-1386).

All participating parties agreed that a compromise would be the best method of expediting the reorganization, if *all* interested parties could *agree* on a plan of reorganization. The Courts then appointed a "Compromise Committee", consisting of three representatives of *certain* secured creditors, to confer with all the interested par-

ticipating parties and to compromise, if possible, all the conflicting claims before the next court hearing. The committee consisted of the two attorneys representing the Trustees and Bondholders' Protective Committee, respectively, of the First and Consolidated 6% Seaboard System Mortgage; the third member was counsel for the Underlying Bondholders' Committee, which held on deposit bonds of all ten underlying mortgage divisions and purported to represent all ten of these secured issues.

The "Compromise Committee", between the hearing on November 5th and the next hearing on November 29th, held separate conferences with the parties, purportedly considered the testimony and arguments presented at these conferences (called "hearings"), and finally recommended as a fair compromise to the District Courts *certain modifications* of the Plan proposed by the Special Master.

No agreement to compromise was ever entered into by any of the interested participating parties. The Compromise Committee adopted the attitude that it was functioning in a *judicial capacity* (R. Vol. I, Comp. Com. Exh. I, 415, 417, 418, 420).

At the hearings resumed on November 29th before the District Courts, and in their Report, the Compromise Committee gave no reasons for, nor did they explain, the methods by which they obtained the results they recommended, but stated that the results were obtained from the exercise of an *informed judgment* (R. Vol. I, 418). Mr. Wyer* (Underlying Committee's expert) testified that he *could not subscribe to the methods used* for obtaining the compromise, but was in favor of its results (Ct. Trans. p. 1416), and Mr. Kennedy* (First and Consolidated Mortgage expert) testified likewise. Thereafter, at the same hearing and in open Court, the Plan submitted by the Spe-

*These were the leading experts employed by the members of the Compromise Committee.

cial Master together with the modifications recommended by the "Compromise Committee" were adopted by the District Courts.

The paramount issue in the hearings before the District Courts on the Plan of Reorganization involved the equitable redistribution of the surplus securities (in excess of $34,000,000) and surplus funds released by the wartime earnings.

In contradistinction, the dominant issues in the hearings before the Special Master involved the capitalization of the new company and the segregation formula to be adopted to determine the earnings of the various divisions. The Special Master's hearings terminated on July 24, 1942. The problem, as to the distribution of the wartime earnings and the surplus securities released with those earnings, did not appear until some time thereafter.

As indicated during the years 1942 and 1943, the Receivers purchased and acquired $34,000,000 outstanding Receivers' Certificates and other secured obligations of the System (R. Vol. I, 90). These securities were purchased with funds principally acquired from huge wartime earnings accumulated during the years 1942 and 1943. The net earnings for the Seaboard System in 1941 were about $10,000,000. It was not until the year 1943 that it was ascertained that the net earnings for the Seaboard System for the year 1942 were $34,566,000, and subsequently that the net earnings for the Seaboard System for the year 1943 were about $28,000,000* (R. Vol. I, 96, 123).

After the close of the hearings before the Special Master, but before the Special Master filed his Report, the "Virginia Court", in order to simplify and expedite the reorganization, and as a step in reorganization, authorized the Receivers to acquire, out of available cash, a portion

*The estimated net earnings for the year 1944 were about $24,000,000 The gross earnings in 1943 and 1944 were as great or greater than 1942, but the net earnings less, due to increased Federal Taxes and increased labor costs

of the outstanding Receivers' Certificates, two of the ten issues of underlying bonds, a substantial part of the outstanding bonds of the Seaboard-All Florida Railway (a leased line of the System), and also certain collateral which had been pledged. Under Court orders, the purchased securities (about $12,000,000) were not to be cancelled, but were to be held for the benefit of the remaining secured creditors of Seaboard. The Special Master at the time he filed his Report in July, 1943, in order to dispose of these surplus securities, proposed a *Secondary Allocation* of these released securities among the various mortgage divisions of the System on the basis of their relative *earnings* indicated *during the period 1936 to 1940*, as shown by the "Kennedy Segregation Formula" which had been applied to this period (R. Vol. II; see Table I-B and Table II to the Special Master's Report).

After the filing of the Special Master's Report in July, 1943, the Virginia Court directed the additional purchase by the Receivers of the remaining outstanding Receivers' Certificates* (approximately $12,000,000 principal amount). That purchase, and certain other modifications of the Special Master's Plan providing for cash payments instead of the issue of securities to certain bond issues, released for redistribution the First Mortgage Bonds and certain junior securities originally allotted to the purchased securities in the Plan and to the securities for which cash payments were provided. The securities so released were in excess of $34,000,000.

The Special Master's Second Allocation proposed the redistribution of all these released securities among *only* those mortgage divisions which indicated segregated earnings during the pre-war period 1936 to 1940.

Several of the underlying mortgage divisions (including the Georgia and Alabama Railway) showed no segre-

*To which 30% in cash and 70% in First Mortgage Bonds had been allocated in the Plan recommended by the Special Master.

gated earnings during the pre-war period 1936 to 1940 under the adopted formula. On the other hand, these same mortgage divisions showed large segregated earnings during the years 1942 and 1943 (and unquestionably in 1944 and 1945). It was urged by the petitioners herein, and representatives of the other so-called deficit divisions, that since the cash available to make the payments which resulted in the release of the securities which were to be redistributed came from earnings of 1942 and 1943, and since in 1942 and 1943 the revenue had been so high that even the so-called deficit lines showed substantial earnings, it would be unfair to allocate these securities on the basis of the segregated earnings for the period 1936 to 1940 which was used for the Primary Allocation, since the System's earnings for 1942 and 1943 were in substantial part produced by the so-called deficit lines. Thus, under the theory and Second Allocation recommended by the Special Master, the Georgia and Alabama division, which had earned in 1942 in excess of $1,000,000* under the same formula (R. Vol. I, 411), and which, it had been estimated, earned in 1943 $1,500,000 to $2,000,000 (R. Vol. I, 370-371), would receive none of the securities released for redistribution (in excess of $34,000,000) because it had shown no earnings in the pre-war period 1936 to 1940.

In its Report, the Compromise Committee stated that it recognized the fundamental fairness and equity of providing for the distribution of normal earnings to holders of securities *whose properties have produced such earnings*, and also referred to similar recognized proposals in other proceedings (R. Vol. I, 419). The Committee purportedly gave effect to this principle by the use of a Third (Tertiary) Allocation, which it recommended to the District Courts as *a compromise*.**

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*This evidence was uncontroverted.

**All of the members of the Compromise Committee actively represented so-called "earning" divisions (which showed segregated earnings in 1936-1940) and benefited substantially in the reallocation of released securities under the methods they recommended which were adopted by the courts below.

The Tertiary Allocation, in effect, distributed approximately one-third (less than $12,000,000) of the new securities and cash released by the Receivers' recent purchases among all the various mortgage issues (including the Georgia and Alabama bonds) on the basis of the interest or dividends which would have been paid on the securities allotted to the respective issues if the Plan had gone into effect on January 1, 1942, including dividends of $3.50 per share on the new common stock.

On that basis, every secured issue participated equitably in the reallocation of released securities distributed under the 3rd Allocation, *but* the Tertiary Allocation was *not* applied to *all* the securities released for reapportionment by the wartime earnings. The Tertiary Allocation applied at most to *only one-third* of the new securities released; the bulk (more than two-thirds) of the securities and cash released were distributed under the Master's Secondary Allocation, which, in turn, was based entirely on the segregated earnings of each mortgage division indicated during the pre-war period 1936 to 1940. Thus, under the Secondary Allocation, a mortgage division which earned during the period 1942 and 1943 only 3% of the System's revenue, but which earned during the period 1936 to 1940 6% of the System's revenue, would receive 6% of the securities to be reallocated, whereas a division (such as the Georgia and Alabama) which earned during the period 1942 to 1943 3% or more of the System's revenue, but which earned during the period 1936 to 1940 no revenue, would receive none of the securities to be reallocated.

It will be noted that in effect the approved Plan of Reorganization consists of three separate allocations: the Primary and Secondary Allocations recommended by the Special Master, and the Tertiary Allocation recommended by the Compromise Committee, which partially modified the Secondary Allocation with respect to a small propor-

tion of the securities and cash released by the wartime earnings. It will be further noted that the Tertiary Allocation, in effect, distributes its released securities among the various mortgage divisions on the basis of the relative *values* found for these mortgage divisions in the two previous allocations made by the Special Master. The securities previously allocated to these divisions by the Primary and Secondary Allocations, not only fixed their relative values, but likewise determined the share they were to receive of the securities distributed under the Tertiary Allocation. If the Secondary Allocation was erroneous, as contended, the Tertiary Allocation multiplied the error.

Capitalization and Basis for Distribution of New Securities Under Approved Plan.

The capitalization* proposed for the new company by the Special Master and approved by the Courts below consisted of the following: $32,500,000 First Mortgage Bonds; $52,500,000 Income Bonds; $15,000,000 Preferred Stock; and $85,000,000 Common Stock; making a total capitalization in the sum of $185,000,000 of new securities to be apportioned among the various secured creditors of the System.

Primary Allocation.

(1) *Distribution of First Mortgage Bonds*: The Special Master recommended (and the Courts approved) that the Primary distribution of First Mortgage Bonds among the various secured issues should be made on the basis of their relative average earnings for the period 1936 to 1940, as shown by the application of the "Kennedy Segregation Formula". First Mortgage Bonds were distributed *only* to divisions showing earnings during this test period, and were apportioned relatively, in the ratios indicated by these earnings.

*Petitioners have not questioned the capitalization recommended by the Special Master and approved by the Courts below.

(2) *Distribution of Income Bonds*: The Special Master recommended (and the Courts approved) that the Primary distribution of Income Bonds should be made in the following manner: 50% were allocated (like the First Mortgage Bonds) among the various issues on the basis of their segregated earnings during the test period of 1936 to 1940; and the remaining 50% were allocated on the basis of the net value (after estimated out-of-pocket expenses) of freight contributions made by each of the various mortgage divisions to the System during the same test period.*

(3) *Distribution of Preferred and Common Stock*: The Preferred and Common Stock were also allocated to the extent of one-third thereof on the basis of segregated earnings indicated in 1936 to 1940; one-third on the basis of net value of traffic contributions; and one-third on the basis of physical value of property (reproduction costs new, less depreciation (R. Vol. II, 227-258).

Secondary Allocation.

After the close of the hearings before the Special Master but before he filed his Report, the "Virginia Court" authorized the Receivers to acquire out of available cash a portion of the outstanding Receivers' Certificates and certain of the secured issues of the Seaboard System, in addition to certain pledged collateral (in the amount of approximately $12,000,000). The Special Master made a Secondary Allocation of *these* released securities on the basis of relative earnings among only those secured issues which showed segregated *earnings during the period 1936 to 1940* and recommended a similar distribution of all ad-

*With the exception of $7,500,000 of Income Bonds which had been initially allocated as First Mortgage Bonds and which were classified into Income Bonds in the interests of conservatism; these bonds were all distributed on the basis of segregated earnings just as First Mortgage Bonds.

ditional securities released by subsequent wartime earnings.

Tertiary Allocation.

After the filing of the Special Master's Report, the "Virginia Court" directed the purchase by the Receivers of the remaining outstanding Receivers' Certificates (approximately $12,000,000 principal amount), That purchase, and certain *other modifications* of the Special Master's Plan providing for cash payments instead of the issue of sesurities to certain bond issues, released for redistribution First Mortgage Bonds and certain junior securities in excess of *$34,000,000* originally allotted to the purchased securities and to the securities for which cash payments were provided. The Tertiary Allocation distributed approximately one-third (less than $12,000,000) of the new securities and cash so released among all the various secured issues (including the Georgia and Alabama bonds) on the basis of the interest or dividends which would have been paid on the securities allocated to the respective issues if the plan had gone into effect on January 1, 1942. The balance and bulk of the surplus securities were redistributed under the Secondary Allocation.

Treatment of Georgia and Alabama Bonds.

The Georgia and Alabama Railway First Mortgage Consolidated Five Percent Bonds, Due October 1, 1945, represented by petitioners, are a *first mortgage lien* on approximately 393.53 miles of railroad in the States of Georgia and Alabama.

There are $6,085,000 Georgia and Alabama bonds issued and still outstanding with accrued interest due and unpaid in the sum of $3,803,125. The total claim amounted to $9,888,125 or $1,625 per $1,000 bond (as of January 1, 1944).

The Georgia and Alabama bonds do not receive the full amount of their claim in the new securities allotted to them in the modified and approved Plan of Reorganization.

The total face amount of securities allotted to the Georgia and Alabama bonds in the Primary Allocation was $6,008,185, consisting of the following junior securities: Income Bonds $1,599,640; Preferred Stock $659,797; and Common Stock $3,748,748.

The Georgia and Alabama bonds did not receive any First Mortgage Bonds under the Primary Allocation, because they showed no segregated earnings during the period 1936 to 1940 used as a basis for distribution. They similarly received no Income Bonds distributed on the basis of segregated earnings, but were allotted Income Bonds on the basis of their traffic contributions. They were allotted Preferred and Common Stock on the basis of their traffic contributions, and also on the basis of the physical value of their properties, but none on the basis of segregated earnings.

In the Primary Allocation each Georgia and Alabama $1,000 bond on which there was accrued principal and interest in the sum of $1,625 received the following:

Income Bond	$260.25
Preferred Stock	107.35
Common Stock	609.90
Total Face Value	$977.50

Under the Secondary Allocation, the Georgia and Alabama bonds received *no* additional securities, because they showed no segregated earning during the period 1936 to 1940, used as a basis to determine the reallocation of the released securities.

Under the Tertiary Allocation, the Georgia and Alabama bonds received in face amount the following additional securities:

First Mortgage Bonds	$357,408
Income Bonds	$ 13,983
Preferred Stock	$ 3,262
Common Stock	$ 28,614

Under the final Plan of Reorganization as modified and approved by the Courts, the bondholders of the Georgia and Alabama Railway received the following securities per $1,000 bond:

First Mortgage	*Income Bond*	*Pref. Stock*	*Com. Stock*
58.74	262.55	107.88	614.61

The total *face value* of the above securities consisting mostly of junior securities amounts to $1,043.78, whereas the total first lien claim of each Georgia and Alabama bond for principal, and accrued interest to January 1, 1944 is $1,625.

It is estimated that if the surplus securities distributed under the Secondary Allocation had been properly distributed, similarly to the method used in the Tertiary Allocation, the Georgia and Alabama Division would have received additional securities in the amount of at least $1,315,800 without taking into account the surplus cash released by wartime earnings in 1942, 1943, 1944 and 1945.

Proceedings Heretofore.

Appeals were taken by the petitioners from the orders of the "Virginia Court" (primary Court) and "Florida Court" (ancillary Court) approving the Plan of Reorganization as fair and equitable, since both were courts of original jurisdiction. The decree of the "Virginia Court" was affirmed by the Circuit Court of Appeals for the Fourth Circuit, *Badenhausen et al.* v. *Guaranty Trust Company et al.*, 145 F. (2d) 40. An application

for certiorari from the Fourth Circuit Court judgment was made to this Court and denied on January 8, 1945, 65 Sup. Ct. Rep. 440. The appeal in the Circuit Court of Appeals for the Fifth Circuit was stayed pending the determination of the appeal in the Circuit Court of Appeals for the Fourth Circuit and the certiorari to the Supreme Court therefrom. Thereafter, on March 10, 1945, the Circuit Court of Appeals for the Fifth Circuit heard the appeal on its merits and on April 10, 1945 affirmed the decree of the "Florida District Court," confirming and approving the Plan of Reorganization, 148 Fed. 2nd 450.

Since the denial of the previous application for certiorari in 65 Sup. Ct. Rep. 440, and the decision of the Circuit Court of Appeals for the Fifth Circuit which petitioners now seek to review, there have been decisions by other Circuit Courts of Appeals on the same matter and issues involved herein, which are in direct conflict with the decisions of the Circuit Court of Appeals for the Fifth Circuit and Fourth Circuit in these proceedings. These decisions relate specifically to the proper redistribution among the remaining several creditors of surplus securities and surplus cash released through wartime earnings in a railroad reorganization. In the interests of uniformity it is respectfully submitted that these questions should be finally and authoritatively settled by this Court.

This Court Has Jurisdiction.

The jurisdiction of this Court to review the judgment here in question is invoked under the Act of February 13, 1925, amending the Judicial Code, Sec. 240, Title 28, U. S. C. A., Sec. 347, and under Rule 38, subdivision 5, of the Rules of the Supreme Court.

The date of the entry of the judgment of affirmance of the Circuit Court of Appeals sought to be reviewed herein is April 10, 1945 (R. Vol. I, 637-641).

In the interest of brevity, petitioners respectfully refer the Court to the following portions of this petition for a complete statement of the actual grounds on which the jurisdiction of this Court is invoked under Rule 38, subdivision 5, of the Rules of the Supreme Court.

Questions Presented.

(1) Was the distribution of huge wartime earnings accumulated in 1942 and 1943 and the redistribution of more than $22,000,000 in surplus securities released or acquired through these wartime earnings, allocated by the Courts below to *only* those mortgage divisions which showed segregated earnings during the period 1936 to 1940, *fair and equitable*, particularly to those divisions whose properties admittedly produced the wartime earnings accumulated during 1942 and 1943 but which nevertheless failed to show segregated earnings during the pre-war period of 1936 to 1940, or was it discriminatory in favor of certain classes of creditors?

(2) Did the failure of the Courts below to provide for the distribution among the remaining creditors of

(a) the excess working capital and surplus current assets on hand;

(b) the surplus securities released by cash payments or provisions from the wartime earnings;

(c) the excess war earnings or profits which may reasonably be expected to accrue during the rest of the war period;

render the Plan of Reorganization unfair and inequitable and discriminatory, particularly as to those creditors who hold 1st mortgage liens and whose claims have not been fully provided for in the Plan of Reorganization?

(3) Did the District Courts and the Circuit Court of Appeals, in approving the Plan of Reorganization as fair and equitable, exercise an independent judgment based upon the evidence, or was the Plan accepted and approved as a compromise agreement to which most of the principal parties had consented in order to expedite the Reorganization?

Reasons Relied on for Allowance of Writ.

This case involves important questions of Federal Law on which a conflict exists between several Circuit Courts of Appeal on the same matter.

This Court has never decided the question of what constitutes a fair and equitable distribution among the remaining creditors of *realized* wartime earnings or a fair redistribution of securities provided for in an existing plan of reorganization and subsequently released by wartime earnings through cash provisions made in a railroad reorganization. Nor has this Court decided whether it is fair and equitable to secured creditors whose claims have not been fully paid or compensated in a plan of reorganization to permit excessive current assets and surplus working capital (obtained from wartime earnings and reasonably expected to accrue during the war period) to be carried forward in a reorganization and to inure to the benefit of those creditors whose claims have already been fully compensated in the plan of reorganization.

These questions are of paramount and vital importance in every existing railroad reorganization throughout the United States. These questions have not been, but should be, settled by this Court.

It is a matter of judicial and common knowledge that every railroad in the United States has benefited tremendously in traffic and earnings during the present wartime crisis. Since the Courts and the Interstate Com-

merce Commission in all receivership and bankruptcy cases have insisted upon a conservative recapitalization which will prevent the reoccurrence of any future bankruptcy or insolvency, the resulting effect has been that practically all railroads are carrying current assets and working capital, consisting of cash and current securities, far in excess of what is needed for the efficient operation of the road or its working capital. Consequently, virtually all railroads are today engaged in reducing their fixed charges and refinancing themselves by acquiring their outstanding secured issues or obligations carrying high interest charges at market prices generally far below their par value. In the case of railroads in reorganization, the securities so purchased or acquired by the receivers or trustees no longer require the new securities originally allotted to them in the plan of reorganization, and the surplus securities must be redistributed equitably among the remaining creditors.

In the instant case, the securities involved and to be reallocated in 1943 alone were in excess of $34,000,000. In addition, there remained many millions of dollars of excess current assets and working capital in the hands of the Receivers. Thereafter, in 1944, Seaboard acquired in net earnings an additional $24,000,000, and it is estimated that in 1945 its net earnings will approximate that of 1944. This condition has been true to a great extent in practically every railroad reorganization now pending.

No uniformity exists as to the method of distributing these surplus securities and funds. The method differs practically in several judicial circuits. In the "Milwaukee" case (*Group of Institutional Investors* v. *Chicago, Milwaukee, St. Paul & Pac. R. R. Co.*) 318 U. S. 561, 563, this Court held that in principle the various creditors of the insolvent corporation should receive in the new securities to be issued by the new corporation the *equitable equivalent position* each formerly possessed. Unless the

surplus securities and excess funds obtained by the wartime earnings are fairly and equitably distributed, the remaining secured creditors who have not been fully compensated for their claims cannot receive in new securities the equitable equivalent position each formerly possessed, particularly when these secured creditors have substantially contributed to these wartime earnings.

In the instant case, under the Secondary Allocation adopted by the District Courts and sanctioned by the Circuit Court of Appeals, the *bulk* of these excess securities and surplus funds had been distributed to only mortgage divisions which showed earnings during the period 1936 to 1940, when the earnings were at a far lower level than the period during which the wartime earnings were accumulated. Many of the mortgage divisions (including the Georgia and Alabama Railway) showed no net earnings during the period 1936 to 1940 and were designated "deficit lines", whereas during the years when the wartime earnings were accumulated, the Georgia and Alabama Railway* and other so-called "deficit lines" admittedly became earning lines which produced much of the cash or excess securities now being distributed. Nevertheless, they fail to share or participate in this distribution.

Since the holders of securities whose properties have produced such earnings do not participate in the distribution of the earnings (or the surplus securities released by these earnings), they do not receive the equitable equivalent position they formerly possessed in accordance with the principles expressed by this Court in the "*Milwaukee*" case, *supra*, and the method of distribution adopted in these proceedings by the Courts below is in conflict with applicable decisions of this Court.

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*The record shows that the Georgia and Alabama division earned in 1942 3% of the total system revenue (R. Vol. I, 411).

There is no legal precedent or logical reason for this principle or method of distribution.

It is in conflict with similar distributions, such as that affirmed by the Circuit Court of Appeals for the Second Circuit in the case of *In re New York, New Haven & Hartford R. Co.*, 147 Fed. (2d) 40 (hereinafter referred to as the "New Haven case"). In the "New Haven case", the Interstate Commerce Commission, in its plan, proposed that the securities originally allotted, but released by cash payments made under order of the Court out of current earnings of the System, be redistributed among the remaining secured creditors not already awarded the full value of their claims ratably in proportion to the *amount* of their claims. Objection was made to the basis of this distribution. The District Court sustained this objection, 54 F. Supp. 607, 608, on the ground that a creditor whose security is the same in quantity and quality as that of his neighbor is not entitled to a more generous allotment of bonds simply because his claim is greater. The District Court decided that the redistribution of surplus securities be established by mathematical computations based solely upon the findings of the *values* of the several issues already made by the Commission and which constituted the foundation of the plan under consideration. The correction made by the District Court of the redistribution of excess securities was subsequently approved and modified by the Commission in its fifth supplemental report. The Circuit Court of Appeals, for the Second Circuit, specifically approved of this correction and distribution, 147 Fed. (2nd) 44.

On the other hand, the *Tertiary* Allocation recommended by the Compromise Committee in the instant case and approved by the Courts below, which distributed *less than $12,000,000* of the surplus securities and cash released by the wartime earnings, recognized the true principle of distribution adopted by the Second Circuit Court in the "New Haven case".

The Compromise Committee, in its Report, stated:

> "It may well be noted that as to the fundamental principle of fairness and equity in approving for distribution the abnormal war earnings to holders of securities *whose properties have produced such earnings,* generally similar proposals, different in method and form, have been made and have been or are being dealt with in railroad reorganization proceedings pending before the Interstate Commerce Commission and the federal courts" (R. Vol. I, 419). (Emphasis supplied.)

The Compromise Committee stated that it gave effect to this principle by the use of the Tertiary Allocation. The Tertiary Allocation redistributed the small amount of the released securities to which it applied among *all* the secured issues by mathematical computations based solely upon the findings of the *values of the several issues* in the Plan's two previous Allocations. This was done by the medium of distributing the released securities as if they were declared dividends which would have been paid on the securities allocated to the respective issues if the Plan had gone into effect on January 1, 1942. The Tertiary Allocation adopts and follows the principle of distributing surplus securities adopted in the "New Haven case", which was approved by the Circuit Court of Appeals for the Second Circuit (147 Fed. [2d] 40, 44). Conversely, the Secondary Allocation approved in the instant case by the Circuit Court of Appeals was contrary to the principles approved by the Circuit Court of Appeals for the Second Circuit and discriminated unfairly and failed to give due recognition to the rights of the Georgia and Alabama bondholders, in favor of other classes of creditors who, alone, showed segregated earnings during 1936 to 1940.

Petitioners likewise contend that the decision which they seek this Court to review is also in conflict with

the decision of the Circuit Court of Appeals for the Tenth Circuit in the case of the *Denver and Rio Grande Western Railroad Company, et al.* v. *Insurance Group Committee, et al.*, ... Fed. (2d) ...* In the "Denver and Rio Grande" case, the Circuit Court of Appeals reversed the order of the District Court approving the plan of reorganization recommended by the Interstate Commerce Commission, because the plan *failed* to make equitable distribution among the remaining creditors of the surplus cash and current assets on hand; failed to make equitable and fair distribution of capitalized securities released through cash payment or purchase; and also because it failed to make equitable provisions for the distribution to the creditors whose claims had not as yet been paid in full of the excess war profits which may reasonably be expected to accrue during the war period.

The Plan of Reorganization approved in these proceedings by the Circuit Court of Appeals definitely makes no such provision and conflicts with the decision of the Circuit Court of Appeals in the "Denver and Rio Grande" case.

The petitioners contend that the decision in the instant case by the Circuit Court of Appeals further conflicts with the decision of the Second Circuit Court of Appeals in the "New Haven case" (*supra*), in that the approval of the Plan of Reorganization by the Courts below as fair and equitable was predicated substantially upon a compromise agreement assented to by a very large majority of the debenture holders. The *record* and the *opinion* filed by the "Virginia Court", which was confirmed and concurred in by the "Florida Court", makes it clear that the issues before the District Courts were decided not on a legal or judicial basis, but on a compromise basis, under the mistaken belief of the District Courts that it was the duty of the Courts to aid in effectuating the Plan

*Not as yet officially reported.

since a very large majority of the major secured creditors had assented to it.

In the "New Haven case", which was a bankruptcy case as distinguished from the instant case, the Second Circuit Court reversed the District Court order approving the plan in so far as the sale of the Old Colony Railroad (a leased line) was concerned, where the record indicated that the purchase price fixed by the Interstate Commerce Commission for the assets of the leased line was made not in the exercise of an independent judgment of the Commission, but predicated substantially upon the fact that the interested parties had agreed on its terms. The Circuit Court of Appeals for the Second Circuit held that the Interstate Commerce Commission must approve a plan of reorganization of a railroad as fair and equitable in the exercise of an *independent judgment*, uninfluenced by the fact that interested parties have agreed on its terms; otherwise, the plan could not be approved as fair and equitable.

Nevertheless, the approval of the instant Plan in Equity as fair and equitable seems to have been predicated by the Courts below substantially on the fact that most of the debenture holders had assented to the Plan and that just how the issues involved in the Plan could be adjusted was more a matter of good business judgment than of legal principle. In view of the record in this case, it cannot be maintained by the respondents that the approval of the Plan as fair and equitable by the Courts below was uninfluenced by the fact that most of the interested parties had agreed upon its terms.

Petitioners further contend that the approval of the Plan as fair and equitable by the District Courts predicated upon this compromise of only certain interested parties, and sanctioned by the Circuit Court of Appeals, so far departed from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision.

Petitioners further submit that the public interest in the uniformity of the administration of justice will be served by this Court's review and by the correction of the patent discrimination and injustice which petitioners believe to inhere in this proceeding.

CONCLUSION.

For these reasons, we respectfully submit that this petition for a writ of certiorari should be granted.

Dated, July 3rd, 1945.

Respectfully submitted,

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